International Chamber of Commerce

*The world business organization*

# Policy Statement

## Exit taxes: serious obstacles for international business restructurings and movements of capital

*Prepared by the Commission on Taxation*

### Introduction

Increasingly, states are implementing so-called exit taxes to protect their taxation rights where companies transfer their seat or their assets to another country. These measures may entail significant double taxation, acceleration of tax claims and considerable compliance burdens for companies. Such corporate transfers of seat or assets have become progressively more common given the international mobility of capital.

As discussed below, exit taxes generally seek in some manner to tax unrealized gains at the moment the company or assets leave the country. However, the fact that the former state has already taxed part of the gain does not automatically mean that the new state in which the realization actually takes place, will take account of such taxes by limiting its taxation right to the value accrued in its country or by granting a tax credit for the taxes paid in the former state. Tax treaties do not generally afford sufficient protection because they lack precise rules to deal with such situations.

Ideally, states would find means to protect their tax bases without resorting to exit taxes. Where such taxes are enacted, ICC believes it is important, in the interests of avoiding excessive or double taxation and protecting the free movement of capital and the efficient functioning of enterprises, that certain safeguards be included.

### Different kinds of exit taxes

The domestic law of most states includes provisions to tax unrealized gains when the seat of a company or its assets are transferred abroad. Technically, these regimes generally measure the amount of such unrealised gains by determining the amount which would have been realized had the assets been sold in the market. In effect, the enterprise realises "phantom" income as if it had sold its inventory, fixed assets and perhaps intangible property at market value.

The scope of such exit taxes varies among states. In addition to the taxation of unrealized gains, states may also provide in their domestic law for the recapture of previously enjoyed deductions or deferrals, such as depreciation or reserves. Some states also impose a tax in lieu of dividend withholding tax.

## Harmful effects for the business community

Exit taxes have a number of adverse effects on international business:

- They make it more difficult for companies to restructure and adapt to changing economic conditions in a globalised world. The taxation of phantom income may be an insuperable obstacle to commercial reorganizations that would otherwise occur.

- They withdraw liquidity and net equity by taxation of unrealized gains or by an obligation to provide adequate security for such deemed gains.

- Exit taxes create new complexity and increased burdens of compliance and administration for both companies and tax authorities. A substantial difficulty is to determine the market value of transferred assets.

- Such taxes may lead to double taxation of the same gains. In many cases, the second state simply taxes the full gain on realization with no recognition of the exit taxation previously applied. Even if the second state does provide some form of recognition, excessive taxation may remain if the states do not apply the same valuation.

## ICC recommendations on exit taxes

ICC would prefer that states not enact exit taxes of general application. That position is consistent with certain supranational rules such as EU law providing for non-discrimination and free movement of capital. Exit taxes should, rather, be reserved for exceptional circumstances, perhaps in cases of abusive tax avoidance or where a coordination of taxation between the two states is rendered difficult by the absence of a bilateral tax treaty.

If states believe that they must protect their tax bases by retaining the right to tax unrealised gains in respect of assets transferred abroad, then they should rely on cooperation with other jurisdictions and bilateral tax conventions to preserve their right to tax only upon the actual alienation of property in such a manner as to avoid all double taxation. Such substantive measures of coordination may be coupled with appropriate exchange of information and assistance in collection provisions in the tax convention.

If states do, nonetheless, continue to apply exit taxes, ICC makes the following recommendations as minimum standards in the design and application of such measures.

### 1. Avoidance of double taxation

Exit taxes lead to double taxation if neither the domestic laws of the states involved nor a tax treaty provides a solution. And even if provisions that address double taxation exist, they may be insufficient to eliminate it.

The avoidance of double taxation <u>must be addressed and resolved</u> if countries wish to impose exit taxes. Exit taxation should not be applied if the new country does not provide proper recognition for the gain already taxed by the former state.

## 2. Valuation to follow the arm's length principle

Where an exit tax is based on the fair value of assets at the time the seat or assets of the company are transferred abroad, the determination of value should be based on the application of the arm's length principle, following the OECD guidelines. The new state of residence should adopt the same principle in measuring the gain to be taxed on ultimate disposition. Disputes should be resolved by the means provided for in the applicable tax treaty. Such basic principles for determining value are important to reduce both the risk of double taxation and the complexity of compliance.

## 3. Other recommendations on dealing with exit taxes

Where exit tax is exigible, a taxpayer should always have the possibility to provide adequate security to cover the future tax claim, rather than having to pay the tax immediately.
In case of transfer of the seat of a company, when a permanent establishment (PE) remains in the former state, no exit tax should be levied as long as the PE provides sufficient security for the payment of tax on the deferred gains.

Compliance burdens connected with exit taxes must be minimised. There should be no obligation for the taxpayer to register in both the former and the new state; nor should third parties be obliged to report when a sale of assets takes place or to collect a withholding tax.

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